Kentucky Law Journal

Volume 43 | Issue 1 Article 10

1954

Cancellation Clause as Affecting Mutuality of Obligation--United States v. Weisbrod

Conley Wilkerson
University of Kentucky

Notes and Comments

CANCELLATION CLAUSE AS AFFECTING MUTUALITY OF OBLIGATION—UNITED STATES V. WEISBROD

In the recent case of *United States* v. *Weisbrod*[1] the government invited bids for surplus property. Weisbrod placed a bid which was accepted by the government and a contract was entered into with him. Under the terms of the contract the government reserved the right to withdraw from sale any property prior to its removal without incurring any liability except to refund to the purchaser any amount paid with respect to that property.

When Weisbrod failed both to pay the amount he had bid and to comply with the terms of the contract, the government, after notifying him, resold the items to the highest bidder. The amount of the sale, however, was $670.32 less than Weisbrod's bid and the government brought action to recover that amount as damages for breach of contract.

The U. S. Court of Appeals for the Seventh Circuit held that the condition reserving to the government the right to withdraw the property from sale did not render the contract void for lack of mutuality of obligation, and that therefore the government's acceptance of the bid contractually bound the bidder.

There is much confusion and misunderstanding as to what is meant by mutuality of obligation as a requirement for the formation of contracts. If mutuality of obligation is considered as an undertaking on one side which is commensurate with the undertaking on the other side, or is taken to mean that a contract must be binding on both parties so that an action might be maintained by each against the other, then the statement that mutuality of obligation is essential to every contract is too broad.[2] While consideration is an essential element of contract[3] mutuality of obligation is not, unless the want of mutuality would leave one of the parties without a valid or available

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[1] 202 F. 2d 629 (7th Cir. 1953).

[2] Johnson v. Johnson, 188 Ark. 992, 68 S. W. 2d 465 (1934); Electric Management and Engineering Corp. v. U. S. Light and Power Corp. of Kansas, 19 F. 2d 311 (7th Cir. 1927); United Appliance Corp. v. Boyd, 108 S. W. 2d 760 (Tex. 1937); Zeppenfeld v. Morgan, 168 S. W. 2d 971 (Mo. 1943); 17 C. J. S. 445 (1939).

[3] Golf Shaft and Block Co. v. O'Keefe, 200 Ark. 529, 139 S.W. 2d 691 (1940); Grant v. Long, 33 Cal. App. 2d 725, 92 P. 2d 940 (1939); Coder v. Smith, 156 Kan. 512, 134 P. 2d 408 (1943); Miller v. Bennett, 237 Mo. App. 1285, 172 S. W. 2d 960 (1943).

consideration for his promise.[4] As so used, the doctrine of mutuality of obligation thus becomes only another way of stating that there must be consideration, that where there is no other consideration for a contract, the mutual promises must be binding on both parties,[5] as only a binding promise is sufficient consideration for the promise of the other party.[6]

In unilateral contracts there is never mutuality of obligation.[7] However, in bilateral contracts even though the mutual promises must furnish consideration, to say that there must be mutuality of obligation without further clarification is likely to be misleading. Perhaps the most satisfactory way of defining mutuality of obligation is to say that it should be used to mean that each party is under a legal duty to the other.[8]

In instances where one party is given an option not accorded the other party, such as discontinuing, or extending performance, or of cancelling, or of determining the extent of performance, there is a possibility of confusion. If the option goes so far as to render illusory the promise of the party given the option, then there is insufficient consideration and therefore no contract,[9] but the fact that the option prevents the mutual promises from being coextensive does not prevent

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[4] Sherrill v. Alabama Appliance Co., 240 Ala. 46, 197 So. 1 (1940); Stanton v. Union Oil Co. of Cal., 111 Colo. 414, 142 P. 2d 285 (1943); Johnson v. Johnson, 188 Ark. 992, 68 S. W. 2d 465 (1934).

[5] This statement holds true except where there is a special privilege not expressly reserved in the promise but given by the law, in which case one of the parties may be bound by his promise even though the other is not. Examples: (1) In contracts between an infant and an adult, the adult is bound by his promise even though the infant is not bound by his. (2) Where a promise is voidable for fraud, duress, or illegality, the party defrauded has power to ratify or avoid the contract. The defrauder is bound but the defrauded party is not. (3) Where bilateral contract is within the Statue of Frauds and has been reduced to writing and signed by one party only, the contract is enforceable against the one who signed but is not enforceable against the one who has not signed. (4) Promises of a sovereign government cannot be enforced unless there is legislation authorizing such action, but the unenforceable promise of the government is still sufficient consideration for the promise of the other party. (5) The promise of an insane person is voidable at his election, but still the other party is bound by the contract. See 1 CORBIN, CONTRACTS 465-468 (1950).

[6] Welsh v. Barnes-Duluth Shipbuilding Co., 221 Minn. 37, 21 N. W. 2d 43 (1945); Chalupnik v. Brant, 134 Neb. 465, 279 N. W. 159 (1938); Pepsi-Cola Co. v. Wright, 187 Ga. 723, 2 S. E. 2d 73 (1939).

[7] Podesta v. Mehrten, 57 Cal. App. 2d 66, 134 P. 2d 38 (1943); Chrisman v. Southern California Edison Co., 83 Cal. App. 249, 256 P. 618 (1927). 1 WILLISTON, CONTRACTS 505 (Rev. Ed. 1936).

[8] 1 CORBIN, CONTRACTS 498 (1950).

[9] WILLISTON, CONTRACTS 506 (Rev. Ed. 1936); 1 CORBIN CONTRACTS 529 (1950). Corbin says an "illusory promise is where promisor's option is unlimited, exactly as it would have been had he never used the promissory words at all." For examples of illusory promises see: Fowlers Bootery v. Shelby Shoe Co., 273 Ky. 670, 117 S. W. 2d 931 (1938); Alameda County v. Ross, 32 Cal. App. 2d 135, 89 P. 2d 460 (1939).

them from being binding according to their terms, if the promises were otherwise sufficient consideration.[10]

In the present case we have a bilateral contract in which the only consideration was the respective promises of the parties. Weisbrod promised to purchase and the government promised to sell but retained the privilege to withdraw the property at any time prior to removal without incurring any liability except to refund the money already paid. The problem presented by the cancellation clause is whether or not the reservation of this privilege renders the government's promise illusory and therefore defeats its effect as consideration for Weisbrod's promise.

In *Emde v. San Joaquin County Central Labor Council*[11] it was contended that a contract whereby a dairy sold its milk routes to independent contractors was void because the contract contained clauses authorizing either party to cancel upon giving the adverse party 30 days' notice. The court upheld the contract quoting Professor Williston who said, "If one party to an agreement reserves an unqualified right to cancel the bargain, no legal rights can arise from it while it remains executory." The court went on to assert:

> However the law does not favor arbitrary cancellation clauses based on the mere will or whim of the party independently of the breach of contract. The slightest restriction on the right to rescind may warrant the upholding of the validity of the contract. Slight evidence of the intention of the parties to permit a cancellation for cause only will suffice to uphold it. The intention must be ascertained by reading the contract as a whole.[12]

The condition that cancellation could be made only upon giving 30 days notice was sufficient detriment to satisfy the requirement of sufficient consideration, and therefore the contract was valid.

In the case of *Sylvan Crest Sand and Gravel Co.* v. *United States,*[13] the Sand and Gravel Co. entered into a contract with the government to furnish trap rock to be used in the construction of an airport. Delivery of the rock was to be made as required and in accordance with delivery instructions to be given by the government. Upon the government's refusal to request or accept delivery within a reasonable time, the Sand and Gravel Co. brought suit to recover damages for breach of contract. The contract contained a provision that cancellation could be effected at any time by the government. In defending the action, the government contended that this un-restricted power of

[10] Moon Motor Car Co. of N. Y. v. Moon Motor Car Co. Inc., 29 F. 2d 3 (2d Cir. 1928); Hunt v. Stimson, 23 F. 2d 447 (6th Cir. 1928). 1 WILLISTON CONTRACTS 507 (1936).

[11] 132 P. 2d 279 (Cal. 1943).

[12] *Id.* at 292.

[13] 150 F. 2d 642 (2d Cir. 1945).

cancellation caused their promise to be illusory and therefore no binding contract resulted. The District Court held for the government and on appeal the Circuit Court of Appeals for the 2d Circuit reversed saying:

> We believe that the reasonable interpretation of the document is as follows: "We accept your offer to deliver within a reasonable time, and we promise to take the rock and pay the price unless we give you notice of cancellation within a reasonable time." Only on such an interpretation is the United States justified in expecting the plaintiff to prepare for performance and to remain ready and willing to deliver. Even so, the bidder is taking a great risk and the United States has an advantage. It is not "good faith" for the United States to insist upon more than this. It is certain that the United States intended to bind the bidder to a "contract," and that the bidder thought that the "acceptance" of his bid made a "contract." A reasonable interpretation of the language used gives effect to their mutual intention. Consequently we cannot accept the contention that the defendant's power of cancellation was unrestricted and could be exercised merely by failure to give delivery orders.[14]

Therefore by considering that the government could cancel only upon giving reasonable notice, the court said that the promise is not made illusory by the fact that the promisor has an option between two alternatives, either of which would be sufficient consideration if it alone were bargained for. The alternative of giving notice is sufficient consideration to support the contract.

Was the option to withdraw in the *Weisbrod* case one which the government could exercise at its will with no restriction whatsoever? If so, the promise was illusory and could not serve as consideration to support the promise of Weisbrod, with the result that no binding contract was formed.

In the *Weisbrod* case the court said that in disposing of property under the Surplus Property Act the government could attach such reasonable conditions as were necessary for general welfare. The Act[15] provided that its objectives were, among other things, to regulate the orderly disposal of surplus property so as (a) to assure the most effective use of such property for war purposes and the common defense, and (h) to assure the sale of surplus property in such quantities and on such terms as will discourage disposal of it to speculators or for speculative purposes.[16]

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[14] *Id.* at 644.

[15] 58 Stat. 765, Sec. 2, as cited in United States v. Weisbrod, 202 F. 2d 629, 632 (7th Cir. 1953).

[16] *Ibid.* Sec. 5 of the Act provides for the Surplus Property Board and states in sec. 6, that the activities of the board shall be coordinated with the programs of the armed forces of the United States in the interest of the war effort. Until peace is concluded, the needs of the armed forces are hereby declared and shall remain paramount. The Board shall have general supervision and direction as

Since this contract was under authority of the Act and since the conditions set out in the contract were apparently made in order to carry out the purpose of the Act, it is perhaps permissible to look behind the plain meaning of the words used in the contract and infer that the property could only be withdrawn on good and sufficient cause, such as to supply the needs of the armed forces. Such a privilege to withdraw the property only upon the happening of some extrinsic event and not dependent upon the whim or caprice of the government would not destroy the effect of its promise as valuable and sufficient consideration to support the promise of Weisbrod.[17]

Even if it is considered that the reserved power to withdraw the material before delivery was not conditioned or restricted to withdrawing for cause, then using the construction given the contract in the *Sylvan Crest Sand and Gravel* case, it seems it would be possible to save this contract by saying that the goods could only have been withdrawn after the government had given the defandent reasonable notice. The reserving of a right to cancel, this right being restricted to the giving of reasonable notice or notice of a specified number of days before cancellation, has been generally held not to destroy mutuality of obligation.[18]

Only three cases[19] have been found involving government contracts containing a clause like the one in the *Weisbrod* case. In each case the validity of the contract was upheld with very little attention being given to the effect of the escape clause.

It is difficult to determine from a reading of the *Weisbrod* case and the other three government cases just what rationalization the court

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provided in this Act over, (1) the care and handling and disposition of surplus property and (2) the transfer of surplus property between government agencies.

[17] Hunt v. Stimson, 23 F. 2d 447 (6th Cir. 1928) (seller reserved the right to cancel the contract if the buyer's complaint could not be satisfactorily adjusted. Held: not void for want of mutuality); Moon Motor Car Co. of N. Y. v. Moon Motor Car Co. Inc., *supra* note 10 (a clause authorizing cancellation if an automobile dealer violated a condition of his contract or prejudicial dissension arose in the organization was held not to destroy consideration).

[18] Sylvan Crest Sand and Gravel Co. v. U. S., 150 F. 2d 642 (2d Cir. 1945); Irwindale Citrus Ass'n v. Semler, 60 Cal. App. 2d 318, 140 P. 2d 716 (1943); Kostanger v. State ex rel. Ramsey, 205 Ind. 536, 187 N. E. 337 (1933); Phoenix Hardware Co. v. Paragon Paint and Varnish Corp., 122 N. J. Eq. 140, 192 A. 45 (1937).

[19] In Silverton v. U. S., 118 Ct. Cl. 232 (1951), the action was against the government for refusal to make delivery after there had been partial performance by the government, and the court held the government's action in refusing to make delivery under the escape clause did not constitute a breach and the plaintiff was not entitled to recover. In Schneiderman v. U. S., 93 F. Supp. 626 (1950), the court held that Schneiderman could not recover damages from the government's failure to deliver 5,600 sets of wrenches which he bought, but did hold the government for breach of a compromise settlement to deliver 3,552 sets. In North & Judd Mfg. Co. v. U. S., 84 F. Supp. 649 (1949), the court held the government was not liable for failure to deliver the remaining portion of strip steel it has contracted to deliver, because of the escape clause in the contract.

used in upholding the contracts and preventing the escape clauses from rendering the government's promises illusory. However, it is submitted that the result reached in the *Weisbrod* case is sound. As inferred by the court in the *Sylvan Crest Sand and Gravel* case, it is unlikely that the government would induce someone to contract with them and then reserve an option to cancel that would render their promise illusory and defeat the contract. It would indeed be a hardship for a person believing in good faith that he has a contract with the government to expend money in making preparations to perform and possibly pass up other opportunities to make profitable contracts, and then find that he does not have an enforceable agreement.

To uphold the good faith of the government, it is submitted that the present case could reasonably be construed to mean that the government might only exercise its right to cancel upon giving notice or for cause. This could be done without doing violence to the contract or the apparent intention of the parties at the time the contract was entered into.

CONLEY WILKERSON

EQUAL PROTECTION—ENFORCEMENT OF RESTRICTIVE COVENANTS

In the 1953 Spring Term of the United States Supreme Court, Mr. Justice Minton read the last rites over the racial restrictive covenant. Delivering the opinion of the court in *Barrows* v. *Jackson*,[1] he answered in the negative the question: Can a racial restrictive covenant be enforced at law by a suit for damages against a co-covenantor who allegedly broke the covenant?[2]

The problem arose when the petitioners sued the respondents at law for damages for breach of a restrictive covenant which the parties entered into as owners of residential real estate in the same neighborhood in Los Angeles, California. Briefly, the covenant provided that each of the signers agreed that he, his heirs and assigns would never allow any of his property to be used or occupied by non-Caucasians other than servants of owners or tenants. This covenant was to run with the land and was to be incorporated in all deeds, papers and transfers of the property. Respondents allegedly conveyed to Negroes

[1] 346 U. S. 249 (1953).

[2] These covenants appear: 1) as conditions in deeds, 2) in contracts for sale of real property, and 3) in agreements between property owners. Note, 20 MISS. L. J. 101 (1948).